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NO. 341

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

H. L. DILLON, JR. ET AL., *Petitioners*

v.

MICHEL T. HALBOUTY, ET AL., *Respondents*

REPLY BRIEF FOR PETITIONERS

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REPLY BRIEF FOR PETITIONERS

To The Honorable Supreme Court of the United States:

Petitioners, H. L. Dillon, Jr., et al., respectfully submit this reply to the several briefs of the respondents.

1. *The federal constitutional questions were timely raised in the motion for rehearing in the Texas Supreme Court, since they all arose from the decision of that Court. Petitioners' claims of violations of their rights under the Fourteenth Amendment were considered and overruled by the Texas Supreme Court.*

The decision of the Texas trial court was favorable to petitioners. On the point of offers to unitize petitioners' leases, the trial court sustained petitioners in their contention that evidence of such offers was immaterial. The Texas Supreme Court was the first court in which a de-

cision adverse to petitioners was rendered. On the issue of unitization, the ruling was contrary to earlier Texas holdings. It was therefore timely for petitioners to raise the federal constitutional issues in a motion for rehearing in the Texas Supreme Court; *Saunders v. Shaw*, 244 U.S. 317; *Missouri ex rel. Missouri Insurance Co. v. Gehner*, 281 U.S. 313; *Granniss v. Ordean*, 234 U.S. 385; *Great Northern Railway Co. v. Sunburst Oil & Refining Co.*, 287 U.S. 358, the decision of the Texas Supreme Court having supplied "a new and unexpected basis for a claim by the defeated party of the denial of a federal right." See *Great Northern Railway Company v. Sunburst Oil & Refining Co.*, supra, at 367.

Cases cited by respondents on this point are all distinguishable on the ground that in those cases (as contrasted with this case) there had been "ample opportunity earlier to present the objection as one arising under the Fourteenth Amendment." See, for example, *American Surety Company v. Baldwin*, 287 U.S. 156, 164, where this distinction is made.

The Texas Supreme Court expressly granted leave to petitioners to amend their motion for rehearing, and said motion, as amended to include the federal constitutional issues here asserted (Appendix "D", petition for certiorari, 73-75) was considered and overruled. (See Appendix "H", petition for certiorari, 89.)

2. *The absence of the Railroad Commission as a petitioner in this Court.*

The Railroad Commission of Texas is an administrative agency of the state and obviously has no property rights

in the gas in the Port Acres Field. The Railroad Commission therefore could not assert any deprivation of property in violation of the due process clause of the Fourteenth Amendment to the United States Constitution. *Stewart v. Kansas City*, 239 U.S. 14; *Smith v. Indiana*, 191 U.S. 138; *Braxton County Court v. West Virginia*, 208 U.S. 192.

As appears from the record in the Texas trial court and the Texas Supreme Court, the Railroad Commission vigorously defended the validity of its order as being in conformity with prior decisions of the Texas Supreme Court. The failure of the Railroad Commission to join in the petition for certiorari is nothing more than a recognition of the law which prevents the Commission from asserting the constitutional issues raised by petitioners.

Petitioners, whose huge investments are directly involved in the outcome of this case, cannot be denied their constitutional rights because of the Commission's legal inability to assert any such rights under the Fourteenth Amendment.

While it is true that the Texas statute providing for appeals from orders of the Railroad Commission, Article 6049c, Section 8, *Vernon's Texas Civil Statutes* (see Henderson Brief, Appendix, 38a), permits the bringing of a suit against the Railroad Commission as the only defendant, any person who will be adversely affected by a judgment cancelling the Railroad Commission's order has a right to intervene to protect his property rights, as the petitioners did without objection in this case. Such interventions are standard practice in such cases, if the real parties in in-

terest are not originally made defendants in the suit to cancel the Commission's order. No question was or could be raised in this case about petitioners' vital interest in the allocation of the gas production as between themselves and the respondents.[1] Petitioners clearly have property rights entitled to protection under the Fourteenth Amendment. The inability of the Railroad Company to assert any such property rights cannot prejudice petitioners' right to raise and urge the constitutional issues her involved. All of the respondents except Peter Henderson Oil Company tacitly recognize that this is true. Henderson cites no authority to sustain its apparent contention that the absence of the Railroad Commission as a petitioner adversely affects petitioners' right to claim protection under the Fourteenth Amendment to the United States Constitution, for the obvious reason that there could be no authority for any such contention.

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[1] See, for example, Pan American Brief, 12:

"No one will question the validity of the Rule 37 drilling permits issued by the Commission to the Petitioners. No one will question the right of Petitioners to drill and produce their wells. **The issue in this case pertains to the amount of gas produced from the wells of Petitioners.**" (Emphasis by Pan American)

See also Halbouty Brief, 5:

"We do agree that the case involves the question of the correlative rights between the operators of standard size proration units on the one hand and the Rule 37, or small tract operators on the other."

Henderson in its brief (footnote, 21) quotes from the opinion of the Texas Supreme Court that "the case is principally one of small tracts that have unitized against small tracts who have preferred not to unitize."

3. *The purpose and effect of the respondents' suit was to secure a judgment which would compel the Railroad Commission to change the allocation formula so as to make it impossible for petitioners to produce enough gas to pay back the cost of drilling and operating their wells. The judgment of the Texas Supreme Court, sustaining respondents' contentions, will mean heavy financial loss to petitioners.*

It is cruel mockery for respondents to argue that "no loss can possibly result to petitioners from the invalidation of the present gas proration order." (Henderson Brief, 6. See also Halbouty Brief, 2-3) Even the opinion of the Texas Supreme Court at least tacitly recognizes that its judgment will "probably entail heavy financial loss" to petitioners. (Appendix "A", petition for certiorari, 47; 357 S.W. 2d at 376) The extent of such loss is indicated by the facts recited in the opinion of the Texas Supreme Court, showing that while the drilling and operating expenses for each of petitioners' wells would be about $361,675.00, the value of the gas produced under a formula based on acre feet of producing sand would be only a gross amount of about $50,867.00. (Appendix "A", petition for certiorari, 36-37; 357 S.W. 2d at 371) It takes only a simple arithmetical calculation to show that the total loss to petitioners, considering only drilling and operating costs for their wells, would approximate $6,000,000.00.

The purpose of respondents' suit is to invalidate the order of the Railroad Commission which would permit petitioners to produce enough gas at least to justify the drilling and operating costs of the wells which petitioners have drilled upon their separate small tracts. As respondents Halbouty, et al., say in their brief (page 10), quoting from

Marrs v. Railroad Commission, 142 Tex. 293, 177 S.W. 2d 941, 950 (1944), the effect of the judgment of the Texas Supreme Court cancelling the proration order of the Railroad Commission will be that "of course the Commission will have to enter substantially different orders." The decision of the Texas Supreme Court unequivocally denies to petitioners the right to an allowable which would "pay the cost of their operations plus profits" and limits them to recovery of "the minerals underlying their properties." (Appendix "A", petition for certiorari, 47; 357 S.W. 2d at 376) While the Texas Supreme Court cannot itself draft an allocation formula, it has adjudicated the legal rights of the interested parties and has settled the law which the Railroad Commission must apply in promulgating the "substantially different" order which it must enter in obedience to the Texas Supreme Court's judgment.

As petitioners stated in their original brief in the Texas Supreme Court (quoted, Henderson Brief in this Court, 6-7), and as we now re-emphasize, the object of respondents' suit is to gain a judgment from the Texas courts which will require the Railroad Commission to adopt an allocation formula on the basis which respondents urge, "substantially in proportion to gas reserves in place." A reading of the opinion of the Texas Supreme Court shows that that Court held that the Railroad Commission is under the legal duty to enter and enforce such an order. The respondents would certainly not be so vigorously defending the Texas Supreme Court's judgment if they did not believe that they had won their case and that to comply with the Texas Supreme Court's judgment the Railroad Commission must enter an order which radically reduces the petitioners' allowable production.

The Texas Supreme Court in its opinion says that the striking down of the Commission's proration order will "enjoin upon the Railroad Commission the duty to write a new order." (Appendix, "A", petition for certiorari, 27; 357 S.W. 2d at 366-367) The opinion as a whole sustains the "hope" of Peter Henderson Oil Company that an order will "soon be entered" radically cutting the allowable production of petitioners' wells by "prorating the production of gas in the Port Acres Field on a reserve or some other reasonable basis and requiring all producers to comply therewith." (Henderson Brief, 16-17)

The decision of the Texas Supreme Court in this case adjudicated legal rights of the competing producers in the Port Acres Field and established the basis on which the Railroad Commission will be required to allocate production in the future. The decision therefore is not merely an interim adjudication in an uncompleted administrative process, but the judgment has the finality which is necessary to the jurisdiction of this Court. *La Crosse Telephone Corporation v. Wisconsin Employment Relations Board*, 336 U.S. 18.

It is true that in the absence of any special field rules, Statewide Rule 25 would apply, and that under this rule petitioners' wells would be allowed to produce more than under the 1/3 per well-2/3 acreage formula which has been cancelled by the Texas Supreme Court. Such a situation, however, could exist only for a brief interval until the Railroad Commission, complying with the decision of the Texas Supreme Court, enters some proration order which will restrict petitioners substantially to the production of the equivalent of the gas in place beneath their tracts. Any production by petitioners under Statewide Rule 25 would be infinitesimal compared to the loss that peti-

tioners will ultimately sustain as a result of the Texas Supreme Court's judgment.

4. *The opinion of the Supreme Court of Texas shows that that Court held that petitioners cannot complain of the huge financial loss that will result to them from the cancellation of the 1/3 - 2/3 allocation formula because the Court finds that petitioners were offered unitization which would afford them a fair share of the mineral proceeds from the common source. This holding was not dictum, as respondents contend.*

In our petition for certiorari (pages 9-10), we quoted in full the concluding three paragraphs of the majority opinion of the Texas Supreme Court. Respondents insist that what the Texas Supreme Court said about an offer of unitization is dictum, and in effect respondents urge that this part of the Court's opinion must be ignored.

The first answer to respondents' contentions is that they refuse to take into account the plain words of the Texas Supreme Court's opinion. The Court is answering the petitioners' complaint that the striking down of the 1/3-2/3 formula will entail "heavy financial loss" to petitioners. The Court's answer is that petitioners drilled their wells "at their own risk." Why? The reason the Court gives immediately follows. It is that "there is some indication in the record by bill of exception that they were offered unitization that would prevent confiscation and afford to them a fair share of the mineral proceeds from the common source."

The Court says nothing about any other reason why petitioners are held to have acted "at their own risk." On

the contrary, the Court goes ahead to discuss unitization, as a permissible procedure. It concludes this paragraph by saying that in cases where the holder of a permit to drill on a small tract has no other means of recovering minerals which underlie his land, the Commission may "by proper order or exception" allow him to recover a sufficient amount of gas to repay drilling and production costs and provide a reasonable profit. The Court, however, says that "no such problem is before us," plainly referring to the bill of exception indicating that petitioners were offered unitization. The Court does not here, or elsewhere in its opinion, give as the reason why petitioners drilled their wells "at their own risk" that this drilling was done pendente lite.

The holding of the Texas Supreme Court, that petitioners were not entitled to complain of the huge financial loss which they will suffer, because they were offered unitization, was certainly not an inadvertent dictum of the Texas Supreme Court. *On the contrary, it was a holding which was urged upon that Court by the respondents.*

The evidence of offers of unitization was offered in the trial court by the respondents, Halbouty, et al., upon the following ground. (S.F., 638).

> "We have requested equitable relief; this is offered, frankly, to put ourselves into equitable position and to meet the contention which will be made, I am sure, that had the allocation formula we are advocating been adopted, these people would have been left high and dry; and I want to be able to show that they had available to them a ready means of being able to realize on their holdings precisely the same as all of their neighbors. That is the whole purpose of it."

Respondent Henderson also urged upon the trial court the admissibility of offers of unitization: (S.F., 644)

> "We think the offers are highly material in the consideration of the allocation of the production."

Petitioners, on the other hand, took the position, both before the Railroad Commission and in the District Court, that evidence of offers to unitize were immaterial because as a matter of law (as decided in all Texas cases up that time) petitioners had the right to develop their small tracts separately and to receive a living allowable for the wells that they lawfully drilled, regardless of any offers by other operators to unitize petitioners' tracts with other tracts. It was inconceivable to petitioners, as it was to the Railroad Commission and the District Court, that the legal right of separate development could be effectually destroyed by so limiting the gas which could be produced from wells lawfully drilled on small tracts that the production could pay for no more than a small fraction of the cost of drilling and producing the wells, if an offer to unitize had been made by adjoining owners. The right of separate development had been regarded as settled. *Halbouty v. Darsey*, 326 S.W. 2d 528 (writ refused, n.r.e.) (Appendix to petition for certiorari, 64-73). Therefore, the District Court refused to admit in evidence the respondents' offers to unitize.

In its original brief in the Texas Supreme Court (page 18), Henderson urged that evidence of its offer to pool its leases with numerous small tracts was highly material in determining the validity of the proration order: (Henderson Original Brief, Texas Supreme Court, 20.)

> "In this case the evidence tendered is highly material as to the effect of prorating the Field on a reserve or acre foot basis as requested by Plaintiffs and Henderson, and to show that the Plaintiffs and Henderson proposed to give the small tract operators a reasonable and fair opportunity to participate in the field's production in proportion to their ownership."

In Henderson's Reply to Appellees' Briefs in the Texas Supreme Court (page 30), Henderson concluded its argument on this point in the following language:

> "Appellees complain that to strike down the order in suit will lead to some future order which will make it so unprofitable to drill the small tracts that no such drilling would be done and a small tract operator's reserves would be lost by drainage to regular unit wells. The tendered evidence was in proof of the fact that that result would not have occurred in the instant case, and it need not occur in any future case. *We respectfully submit that such proof is relevant, is without dispute, and should be fully taken into account by this Court in its opinion and judgment in this case.*" (Emphasis added)

A comparison of the language just quoted from Henderson's brief with the language in the opinion of the Texas Supreme Court in the paragraph relating to offers of unitization (357 S.W. 2d at 376, quoted in petition for certiorari, 9-10) shows beyond any reasonable doubt that the Texas Supreme Court did exactly what Henderson urged. The Court took into account in its opinion and judgment the record (as shown in a bill of exception) of offers of unitization and held that because of such offers petitioners could not complain of the loss of the investments which they had made after refusing to accept such offers of unitization.

5. The opinion and judgment of the Texas Supreme Court deny to petitioners the right to controvert respondents' evidence as to offers of unitization.

We recognize that this Court is not concerned with whether the Texas property law, relating to the rights of the owners of wells lawfully drilled on small tracts, was changed retroactively by the decision of the Texas Supreme Court in this case. However, we respectfully submit, this Court *is* concerned with petitioners' right to a fair hearing upon the issues which the Texas Supreme Court now holds to be material in determining whether petitioners are entitled to a living allowable for their wells. If offers of unitization are material in determining petitioners' right to produce enough gas to pay back their costs, with possibly a reasonable profit, then at least petitioners should be afforded a fair opportunity to offer their controverting evidence as to whether they did in fact receive any valid and fair offers to unitize their small tracts with respondents' tracts and why unitization was not effected. Having ruled, reversing the trial court, that offers to unitize are material, the Supreme Court of Texas should at least have given petitioners an opportunity to present their side of the case on this issue. In refusing to do so, the Court plainly denied to petitioners due process of law.

Respondents now say that while neither the opinion nor the judgment of the Supreme Court of Texas says so, the issue of fair offers to unitize can be passed on by the Railroad Commission in determining whether an allocation order should be entered which will allow petitioners to produce a sufficient amount of gas to repay drilling and production costs. This is certainly not what respondents contended in the Texas Supreme Court. Instead, they suc-

cessfully contended that the offers to unitize, shown in a bill of exception, should be taken into account by the Texas Supreme Court as a basis for holding that the 1/3 - 2/3 order was invalid and that petitioners had drilled their wells at their own risk and could not complain of heavy financial loss which would result to them from the cancellation of the Commission's order. The Texas Supreme Court of Texas does not say that the 1/3 - 2/3 allocation formula is cancelled conditionally or that upon a remand the Railroad Commission still may give petitioners substantially the same allowable, if any offers of unitization by respondents were not fair or valid. All that the Court does is to indicate that perhaps, if no fair offer to unitize had been made, then the Commission might have adopted an order which would allow the holders of Rule 37 permits to recover a sufficient amount of gas to repay drilling and production costs and provide a reasonable profit. However, the Court ruled that no such issue remains in this case by saying: (357 S.W. 2d at 376) (Quoted, petition for certiorari, 10)

"No such problem is before us."

This sentence, construed with the rest of the paragraph which it concludes, evidently means that the Texas Court holds that in this case petitioners as a matter of law drilled their wells at their own risk and that the Railroad Commission has no authority to pass upon any offer of unitization. This case is therefore in marked contrast with cases cited by respondents, such as *Laclede Gas Light Co. v. Public Service Commission*, 304 U.S. 398, in which the controversy was remanded to the administrative agency for further determinations of facts decisive of crucial issues.

6. *If, as respondents argue, the issue of offers of unitization can still be considered by the Railroad Commission, then petitioners are denied due process of law because no reasonably definite standard is given by the Texas Supreme Court, by reference to any statute or otherwise, by which it can be determined whether any offers to unitize were fair and valid so that petitioners must be denied a living allowable for their wells which they have drilled on their separate tracts.*

We have submitted primarily that the Texas Supreme Court has denied to petitioners the right to make their proof anywhere on the issue of unitization. If, however, we are wrong in this primary contention and if respondents correctly argue that the issue of unitization may still be tried before the Railroad Commission, then what are the standards for deciding as to what would be fair and valid offers of unitization?

Respondents concede, as the Texas Supreme Court did (Appendix "A", petition for certiorari, 47; 357 S.W. 2d at 376), that there is no statutory authority to compel unitization. There is statutory authority only for the different owners to agree voluntarily upon a method of unitization. If, therefore, as respondents now contend, the Railroad Commission can still pass on the issue of unitization, there is no statutory standard to guide the Railroad Commission in determining whether any offers to pool were fair and valid.

Nor can any standard be determined from the Texas Supreme Court's opinion. If the Commission must decide the issue of the fairness of offers to unitize, the Court does not tell the Commission what legal guide lines must be followed. Any decision by the Commission must be made on an arbitrary, as distinguished from a definite or reason-

ably ascertainable, basis. Moreover, petitioners, having already spent their money and drilled their wells, would be penalized by having their investments destroyed, if the Commission decides they were wrong in not unitizing their properties, without petitioners' ever having had an opportunity in advance to have this crucial issue determined. For this additional reason, even under respondents' construction of the Texas Supreme Court's opinion, petitioners have been denied due process.

Conclusion

WHEREFORE, petitioners respectfully pray that a writ of certiorari be granted and that the judgment of the Texas Supreme Court be reversed.

Respectfully submitted,

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Subscribed and sworn to before me on this the 28 day of September, A. D. 1962.

J. Brunson

Notary Public in and for Harris County, Texas